Deferred Rate Increases

Background

The Pension Funding Council (PFC) Subgroup of the SCPP originally proposed a 6-year phase-in of projected employer and plan 2 member contribution rates. Additionally, a permanent contribution rate floor would be established at the completion of the 6-year phase-in period.

Committee Activity

Presentations:
September 7, 2004 - Executive Committee
October 19, 2004 - Executive Committee
December 7, 2004 - Executive and Full Committee

Subgroup Activity:
August 31, 2004 - Subgroup Meeting
September 21, 2004 - Subgroup Meeting

Recommendation to Legislature

Establish a schedule of employer and plan 2 member contribution rates for the 2005-07 and 2007-09 biennia. At the completion of the 4-year schedule, establish permanent minimum contribution rates for employers and plan 2 members.

Staff Contact

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Select Committee on Pension Policy

Deferred Rate Increases

(December 15, 2004)

Issue

The Pension Funding Council (PFC) subgroup of the SCPP proposed a 6-year phase-in of projected employer and plan 2 member contribution rates. Additionally, a permanent contribution rate floor would be established at the completion of the 6-year phase-in period.

Staff

Matt Smith, State Actuary
360-753-9144

Members Impacted

All employers and plan 2 members of the Public Employees Retirement System (PERS), Teachers Retirement System (TRS) and the School Employees' Retirement System (SERS) would be impacted. As of September 30, 2003, there were 146,403 plan 2 members in PERS, TRS and SERS. Of this combined total, 117,262 are PERS Plan 2 members.

Current Situation

Provisions governing the current contribution rate setting process are codified under the Actuarial Funding Chapter - Chapter 41.45 RCW. In summary, these provisions provide for the systematic actuarial funding of the state retirement systems. Biennial actuarial valuations performed on odd-year valuation dates are the basis for contribution rate recommendations to the Pension Funding Council (PFC). Contribution rates adopted by the PFC in September of even-numbered years, referred to as "basic rates," are effective during the ensuing biennium subject to revision by the Legislature. Temporary and "supplemental rates" are charged in addition to the basic rates to fund the cost of benefit enhancements that are granted by the Legislature in between the 2-year basic rate cycles.

History

The Pension Funding Reform Act, Chapter 273, Laws of 1989, established a systematic actuarial funding process for the state retirement systems. Contribution rates under the initial Funding Reform Act were scheduled to remain in place for a 6-year period. Additionally, the current funding policy was established including the goal to fully amortize the plan 1 unfunded liability by June 30, 2024. Prior to the Funding Reform Act, pension contributions were subject to a discretionary appropriation by the Legislature.

Projected Contribution Rates

Projected Employer Contribution Rates*

System	Current	2005-07	2007-09	2009-11
PERS	1.18%	5.73%	7.28%	8.44%
TRS	1.17%	6.74%	10.15%	12.73%
SERS	0.85%	7.56%	9.45%	10.69%

** Includes the cost of prefunding the liability for existing gain-sharing benefit provisions.*

Projected Plan 2 Member Contribution Rates*

System	Current	2005-07	2007-09	2009-11
PERS	1.18%	3.38%	4.27%	4.89%
TRS	0.87%	2.48%	4.01%	5.01%
SERS	0.85%	3.51%	4.68%	5.39%

** The member contribution rate in PERS and TRS Plan 1 is fixed at 6%. Plan 3 members do not contribute to the defined benefit portion of their plan.*

PFC Subgroup Proposal

The PFC subgroup of the SCPP proposed a 6-year phase-in of projected employer and plan 2 member contribution rates. Additionally, a permanent contribution rate floor would be established at the completion of the 6-year phase-in period.

Proposed Employer Rates Under 6-Year Phase-In

Employer Rates With Phase-In

Period	PERS	TRS	SERS
2005-06	4.25%	5.00%	6.00%
2006-07	5.25%	6.75%	7.00%
2007-08	6.25%	8.75%	8.50%
2008-09	7.25%	10.75%	10.00%
2009-11	8.44%	12.73%	10.69%
Ultimate Rate*	9.47%	14.59%	11.71%

** The ultimate rate is the maximum projected employer contribution rate for the 25-year period.*

Employer Rates Without Phase-In

Period	PERS	TRS	SERS
2005-06	5.73%	6.74%	7.56%
2006-07	5.73%	6.74%	7.56%
2007-08	7.28%	10.15%	9.45%
2008-09	7.28%	10.15%	9.45%
2009-11	8.44%	12.73%	10.69%
Ultimate Rate*	9.11%	14.28%	11.37%

** The ultimate rate is the maximum projected employer contribution rate for the 25-year period.*

Proposed Plan 2 Member Rates Under 6-Year Phase-In

Plan 2 Member Rates With Phase-In

Period	PERS	TRS	SERS
2005-06	2.75%	2.00%	2.75%
2006-07	3.25%	2.75%	3.25%
2007-08	3.75%	3.50%	4.25%
2008-09	4.25%	4.25%	5.25%
2009-11	4.89%	5.01%	5.39%
Ultimate Rate*	5.35%	5.61%	5.83%

** The ultimate rate is the maximum projected member contribution rate for the 25-year period.*

Plan 2 Member Rates Without Phase-In

Period	PERS	TRS	SERS
2005-06	3.38%	2.48%	3.51%
2006-07	3.38%	2.48%	3.51%
2007-08	4.27%	4.01%	4.68%
2008-09	4.27%	4.01%	4.68%
2009-11	4.89%	5.01%	5.39%
Ultimate Rate*	5.18%	5.53%	5.68%

** The ultimate rate is the maximum projected member contribution rate for the 25-year period.*

Policy Analysis

The proposed phase-in of projected contribution rate increases would represent a temporary departure from existing funding policy and would require a statutory change to the existing funding policy defined under Chapter 41.45 RCW - Actuarial Funding of State Retirement Systems. Employer and plan 2 member contribution rates would drop below the amounts necessary to fully fund the plans 2/3 under the aggregate funding method during the phase-in period and then increase thereafter. Contributions to the amortize the unfunded prior service costs in PERS 1 and TRS 1 during the phase-in period would also drop below the amounts that would otherwise be required and increase thereafter. The amortization date for the Plans 1, however, would remain unchanged.

This proposal is consistent with the existing policy that states that employer contribution rates should be predictable and remain a relatively constant proportion of future state budgets. This proposal would establish a fixed schedule of increasing contribution rates for a 6-year period, thereby increasing predictability, and would smooth out the impact of projected rate increases on future state and local government budgets. The addition of a permanent contribution rate floor at the completion of the phase-in period is also consistent with this policy – increasing the stability and predictability of future contribution rates.

This proposal is inconsistent with the existing policy to fund all Plan 2/3 benefits over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service, and would be a first-time departure from this policy. The proposal would effectively borrow plan assets in the short-term as a means of financing a schedule of deferred rate increases during the phase-in period - without permanently modifying existing funding policy. This would result in short-term savings, followed by a long-term cost.

Estimated Fiscal Impact

Increase in Projected Funding Expenditures

($ in millions)	**GF-S**	**Non GF-S (State)**	**Local Government**	**Total Employer**
2005-07				
PERS	$ (35.8)	$ (59.0)	$ (84.0)	$ (178.8)
TRS	(66.4)	0.0	(13.6)	(80.0)
SERS	(18.4)	0.0	(16.3)	(34.7)
Total Employer	**$ (120.6)**	**$ (59.0)**	**$ (113.9)**	**$ (293.5)**
2007-09				
PERS	$ (19.6)	$ (32.4)	$ (46.1)	$ (98.1)
TRS	(36.5)	0.0	(7.5)	(44.0)
SERS	(3.2)	0.0	(2.9)	(6.1)
Total Employer	**$ (59.3)**	**$ (32.4)**	**$ (56.5)**	**$ (148.2)**

($ in millions)	GF-S	Non GF-S (State)	Local Government	Total Employer
2009-11*				
PERS	$ 0.0	$ 0.0	$ 0.0	$ 0.0
TRS	(4.0)	0.0	(0.8)	(4.8)
SERS	(0.5)	0.0	(0.4)	(0.9)
Total Employer	**$ (4.5)**	**$ 0.0**	**$ (1.2)**	**$ (5.7)**
25 Year				
PERS	$ 73.1	$ 120.7	$ 171.9	$ 365.7
TRS	143.0	0.0	29.3	172.3
SERS	35.2	0.0	31.2	66.4
Total Employer	**$ 251.3**	**$ 120.7**	**$ 232.4**	**$ 604.3**

**2007-09 rate increases for TRS and SERS are effective 9/1/2007 through 8/31/2009.*

The proposed schedule of future rate increases should be adjusted for any significant divergence between actual and assumed experience - including the cost of any future benefit enhancements.

The estimated fiscal impact is based on the proposed schedule of rate increases presented in this paper. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2002 actuarial valuation report and using preliminary contribution rates from the 2003 actuarial valuation. The cost of adding a permanent contribution rate floor is not reflected.

The proposed schedule of future rate increases was developed under an actuarial projection of assets and liabilities. The emerging costs of the affected systems will vary from what is displayed in this paper to the extent that actual experience differs from that projected under the current actuarial assumptions.

This proposal assumes a fixed schedule of increasing contribution rates and a permanent contribution rate floor at the completion of the phase-in period. However a current Legislature cannot obligate a future Legislature for contribution rate increases that would impact a future biennial budget. The proposed schedule of future contribution rate increases, if approved by the 2005 Legislature, could be amended by a future Legislature. If the minimum funding requirements set forth in the schedule were not honored by future Legislatures, the costs in the tables above could be understated.

Revised Proposal (Amended)

The PFC subgroup directed the State Actuary to revise the original proposal to address the following concerns:

- the increases in the ultimate employer and member contribution rates caused by deferring contribution rate increases beyond the phase-in period; and
- the insufficient deferral of rate increases during the first year of the schedule for local government employers under PERS.

The revised proposal eliminates the increases in the ultimate employer and member rates by not deferring rate increases beyond the 4-year phase-in period. In other words, on a present value basis, the deferral of rate increases during the first biennium is offset by rate increases during the second biennium (for both employers and plan 2 members).

Additionally, the revised proposal provides a significant deferral of contribution rate increases for PERS employers and Plan 2 members during the first year of the proposed schedule. However, this significant deferral in year one is followed by significant increases during the third and fourth year of the schedule.

The revised proposal was amended for a .01% correction to the SERS employer contribution rate for 2008-09 and the plan 2 member rates for 2008-09 were adjusted to ensure that the present value of member contributions is equal under the "with" and "without" phase-in schedules.

Proposed <u>Employer</u> Rates Under 4-Year Phase-In

Employer Rates With Phase-In

Period	PERS	TRS	SERS
2005-06	2.50%	5.46%	4.70%
2006-07	5.50%	7.21%	7.45%
2007-08	8.25%	9.57%	10.01%
2008-09	9.96%	11.62%	12.04%
2009-11	8.44%	12.73%	10.69%
Ultimate Rate*	9.11%	14.28%	11.37%

** The ultimate rate is the maximum projected employer contribution rate for the 25-year period.*

Employer Rates Without Phase-In

Period	PERS	TRS	SERS
2005-06	5.73%	6.74%	7.56%
2006-07	5.73%	6.74%	7.56%
2007-08	7.28%	10.15%	9.45%
2008-09	7.28%	10.15%	9.45%
2009-11	8.44%	12.73%	10.69%
Ultimate Rate*	9.11%	14.28%	11.37%

** The ultimate rate is the maximum projected employer contribution rate for the 25-year period.*

Proposed Plan 2 Member Rates Under 4-Year Phase-In

Plan 2 Member Rates With Phase-In

Period	PERS	TRS	SERS
2005-06	1.75%	1.75%	2.25%
2006-07	3.25%	2.75%	3.50%
2007-08	4.75%	3.75%	4.75%
2008-09	5.80%	4.91%	6.34%
2009-11	4.89%	5.01%	5.38%
Ultimate Rate*	5.18%	5.53%	5.68%

** The ultimate rate is the maximum projected member contribution rate for the 25-year period.*

Plan 2 Member Rates Without Phase-In

Period	PERS	TRS	SERS
2005-06	3.38%	2.48%	3.51%
2006-07	3.38%	2.48%	3.51%
2007-08	4.27%	4.01%	4.68%
2008-09	4.27%	4.01%	4.68%
2009-11	4.89%	5.01%	5.38%
Ultimate Rate*	5.18%	5.53%	5.68%

** The ultimate rate is the maximum projected member contribution rate for the 25-year period.*

Estimated Fiscal Impact - Revised Proposal

Increase in Projected Funding Expenditures

($ in millions)	**GF-S**	**Non GF-S (State)**	**Local Government**	**Total Employer**
2005-07				
PERS	$ (55.9)	$ (92.3)	$ (131.5)	$ (279.7)
TRS	(29.4)	0.0	(6.0)	(35.4)
SERS	(23.5)	0.0	(20.8)	(44.3)
Total Employer	**$ (108.8)**	**$ (92.3)**	**$ (158.3)**	**$ (359.4)**
2007-09				
PERS	$ 68.6	$ 113.2	$ 161.3	$ 343.1
TRS	27.6	0.0	5.7	33.3
SERS	24.3	0.0	21.5	45.8
Total Employer	**$ 120.5**	**$ 113.2**	**$ 188.5**	**$ 422.2**
2009-11*				
PERS	$ 0.0	$ 0.0	$ 0.0	$ 0.0
TRS	11.5	0.0	2.3	13.8
SERS	4.9	0.0	4.3	9.2
Total Employer	**$ 16.4**	**$ 0.0**	**$ 6.6**	**$ 23.0**
25 Year				
PERS	$ 12.7	$ 20.9	$ 29.8	$ 63.4
TRS	9.8	0.0	2.0	11.8
SERS	5.6	0.0	5.0	10.6
Total Employer	**$ 28.1**	**$ 20.9**	**$ 36.8**	**$ 85.8**

**2007-09 rate increases for TRS and SERS are effective 9/1/2007 through 8/31/2009.*

Contribution Rate Floor

The PFC subgroup recommended the adoption of a permanent contribution rate floor at the completion of any phase-in period. The following proposed contribution rate floor is consistent with, and could serve as an alternative to, the recommendation provided under the previous committee issue paper "Contribution Rate Setting - July 2, 2004." The minimum Plan 2/3 normal cost rate would apply equally to both employers and Plan 2 employees, and once the Plan 1 UAAL is completely amortized, the Plan 2/3 normal cost would become the minimum contribution rate for employers as well.

Minimum Contribution Rates after June 30, 2009

System	Plan 2/3 Normal Cost	Plan 1 UAAL	Total Employer
PERS	4.00%	2.75%	6.75%
TRS	5.00%	5.75%	10.75%
SERS	4.25%	2.75%*	7.00%

** Contribution to the PERS 1 unfunded liability.*

Executive Committee Recommendation

Staff was directed to prepare bill language for the November Executive Committee meeting and to prepare additional fiscal analysis for the December meeting.

Coordination with Other SCPP Proposals

This proposal was developed independent of the gain-sharing trade-off proposals from the Purchasing Power/Gain-Sharing subgroup. The deferred rate increases under the proposed schedule include gain-sharing costs for the employer. This schedule, and estimated fiscal impact, would require an amendment to exclude employer rate increases due to gain-sharing should another piece of legislation repeal or reduce future gain-sharing benefits.

Bill (Draft) - Amended

Attached. The revised proposal was amended for a .01% correction to the SERS employer contribution rate for 2008-09 and the plan 2 member rates for 2008-09 were adjusted to ensure that the present value of member contributions is equal under the "with" and "without" phase-in schedules.

Additional Fiscal Analysis

The proposed contribution rate schedule departs from the normal biennial rate-setting process by requiring four annual increases in rates. The rates are lower in the first two years than required by the 2003 actuarial valuation and higher in the second two years than required by the projected 2005 actuarial valuation. In other words, the proposal would effectively "borrow" plan assets in the 2005-07 biennium and repay the "borrowed" assets with 8% annual interest during the 2007-09 biennium.

This proposal can be thought of as generating a "short-term debt" to the pension system that would be repaid over the following biennium. The original proposal with a 6-year phase-in would not completely repay the debt over the phase-in period and, as a result, would create a "long-term debt" to the pension system. The payment of the long-term debt is reflected in the increase in the ultimate contribution rates for the affected systems.

Both schedules, whether they generate a short- or long-term debt, will be sensitive to experience that deviates from what is assumed <u>over the phase-in period</u>. Most significant will be the plan's investment performance relative to the 8% assumption. We reviewed this sensitivity and determined it was minor. This is due in large part to the 13.73% preliminary investment rate of return for the plan year ending 9/30/2004 (source: WSIB) and the current asset smoothing method. The preliminary investment gain for the plan year ending 9/30/2004 is not reflected in the proposed schedule and, therefore, will be available to offset a significant portion of any investment loss that may occur during the plan year ending 9/30/2005. Furthermore, the current asset smoothing method dampens the short-term volatility of contribution rates. The results of the 9/30/2005 actuarial valuation will be the basis for the 2007-09 contribution rate recommendations and the basis for any adjustment to the rates in this proposed schedule if necessary.

It should also be noted that the proposed schedule of rate increases during the 2007-09 biennium, if approved by the 2005 Legislature, could be amended by a future Legislature. If the minimum funding requirements set forth in the schedule were not honored by future legislatures, the costs represented in this paper could be understated. For example, if the contribution savings during the 2005-07 biennium were not completely recouped with interest during the following biennium, and if they resulted in a permanent reduction of 2005-07 contributions, the short-term debt would effectively be restructured into a long-term debt that would increase the overall costs to the retirement system.

Fiscal Note (Draft)

A fiscal note on the revised proposal (amended) is attached.

AN ACT Relating to contribution rates for the public employees' retirement system, the teachers' retirement system, the school employees' retirement system, and the public safety employees' retirement system; adding new sections to chapter 41.45 RCW; decodifying RCW 41.45.054; providing effective dates; and declaring an emergency.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** A new section is added to chapter 41.45 RCW to read as follows:

The basic employer and state contribution rates and required plan 2 member contribution rates are changed to reflect the 2003 actuarial valuation and actuarial projections of the 2005 actuarial valuation, both of which incorporate the 2002 actuarial experience study conducted by the office of the state actuary for 1995-2000. This contribution rate schedule departs from the normal biennial process for setting contribution rates by requiring four annual increases in rates. The rates are lower in the first two years than required by the 2003 actuarial valuation and higher in the second two years than required by the projected 2005 actuarial valuation. Upon completion of the 2005 actuarial valuation, the pension funding council and the state actuary shall review the appropriateness of the contribution rates for 2007-2008 and 2008-2009 and by September 30, 2006, the pension funding council shall recommend to the legislature any adjustments as may be needed due to material changes in benefits or actuarial assumptions, methods, or experience. This contribution rate schedule also requires a departure from the allocation formula for contributions in RCW 41.45.050.

(1) Beginning July 1, 2005, the following employer contribution rate shall be charged: 2.50 percent for the public employees' retirement system, of which .50 percent shall be allocated to the unfunded actuarial accrued liability for the public employees' retirement system plan 1.

(2) Beginning September 1, 2005, the following employer contribution rates shall be charged:

(a) 4.70 percent for the school employees' retirement system, of which .50 percent shall be allocated to the unfunded actuarial accrued liability for the public employees' retirement system plan 1; and

(b) 5.46 percent for the teachers' retirement system, of which 2.25 percent shall be allocated to the unfunded actuarial accrued liability for the teachers' retirement system plan 1.

(3) Beginning July 1, 2005, the following member contribution rate shall be charged: 1.75 percent for the public employees' retirement system plan 2.

(4) Beginning September 1, 2005, the following member contribution rates shall be charged:

(a) 2.25 percent for the school employees' retirement system plan 2; and

(b) 1.75 percent for the teachers' retirement system plan 2.

(5) The contribution rates in subsections (1) through (4) of this section shall be collected through June 30, 2006, for the public employees' retirement system, and August 31, 2006, for the school employees' retirement system and the teachers' retirement system.

(6) Beginning July 1, 2006, the following employer contribution rate shall be charged: 5.50 percent for the public employees' retirement system, of which 2.00 percent shall be allocated to the unfunded actuarial accrued liability for the public employees' retirement system plan 1.

(7) Beginning September 1, 2006, the following employer contribution rates shall be charged:

(a) 7.45 percent for the school employees' retirement system, of which 2.00 percent shall be allocated to the unfunded actuarial accrued liability for the public employees' retirement system plan 1; and

(b) 7.21 percent for the teachers' retirement system, of which 3.00 percent shall be allocated to the unfunded actuarial accrued liability for the teachers' retirement system plan 1.

(8) Beginning July 1, 2006, the following member contribution rate shall be charged: 3.25 percent for the public employees' retirement system plan 2.

(9) Beginning September 1, 2006, the following member contribution rates shall be charged:

(a) 3.50 percent for the school employees' retirement system plan 2; and

(b) 2.75 percent for the teachers' retirement system plan 2.

(10) The contribution rates in subsections (6) through (9) of this section shall be collected through June 30, 2007, for the public employees' retirement system, and August 31, 2007, for the school employees' retirement system and the teachers' retirement system.

(11) Beginning July 1, 2007, the following employer contribution rate shall be charged: 8.25 percent for the public employees' retirement system, of which 3.25 percent shall be allocated to the unfunded actuarial accrued liability of the public employees' retirement system plan 1.

(12) Beginning September 1, 2007, the following employer contribution rates shall be charged:

(a) 10.01 percent for the school employees' retirement system, of which 3.25 percent shall be allocated to the unfunded actuarial accrued liability of the public employees' retirement system plan 1; and

(b) 9.57 percent for the teachers' retirement system, of which 4.45 percent shall be allocated to the unfunded actuarial accrued liability of the teachers' retirement system plan 1.

(13) Beginning July 1, 2007, the following member contribution rate shall be charged: 4.75 percent for the public employees' retirement system plan 2.

(14) Beginning September 1, 2007, the following member contribution rates shall be charged:

(a) 4.75 percent for the school employees' retirement system plan 2; and

(b) 3.75 percent for the teachers' retirement system plan 2.

(15) The contribution rates in subsections (11) through (14) of this section shall be collected through June 30, 2008, for the public employees' retirement system, and August 31, 2008, for the school employees' retirement system and the teachers' retirement system.

(16) Beginning July 1, 2008, the following employer contribution rate shall be charged: 9.96 percent for the public employees' retirement system, of which 4.07 percent shall be allocated to the unfunded actuarial accrued liability of the public employees' retirement system plan 1.

(17) Beginning September 1, 2008, the following employer contribution rates shall be charged:

(a) 12.04 percent for the school employees' retirement system, of which 4.07 percent shall be allocated to the unfunded actuarial accrued liability of the public employees' retirement system plan 1; and

(b) 11.62 percent for the teachers' retirement system, of which 5.48 percent shall be allocated to the unfunded actuarial accrued liability of the teachers' retirement system plan 1.

(18) Beginning July 1, 2008, the following member contribution rate shall be charged: 5.80 percent for the public employees' retirement system plan 2.

(19) Beginning September 1, 2008, the following member contribution rates shall be charged:

(a) 6.34 percent for the school employees' retirement system plan 2; and

(b) 4.91 percent for the teachers' retirement system plan 2.

(20) The contribution rates in subsections (16) through (19) of this section shall be collected through June 30, 2009, for the public employees' retirement system, and August 31, 2009, for the school employees' retirement system and the teachers' retirement system.

NEW SECTION. **Sec. 2.** A new section is added to chapter 41.45 RCW to read as follows:

Beginning July 1, 2009, for the public employees' retirement system and the public safety employees' retirement system, and September 1, 2009, for the school employees' retirement system and the teachers' retirement system, minimum basic employer and state contribution rates and minimum required plan 2 member contribution rates are established. In establishing these minimum rates, it is the intent of the legislature to promote contribution rate stability over time. The basic employer and state contribution rates and required plan 2 member contribution rates as recommended by the pension funding council and adopted by the legislature may exceed, but shall not drop below, these minimum rates. Upon completion of each biennial actuarial valuation, the pension funding council and the state actuary shall review the appropriateness of the minimum contribution rates and the pension funding council shall recommend to the legislature any adjustments as may be needed due to material changes in benefits or actuarial assumptions, methods, or experience.

(1) Beginning July 1, 2009, the following minimum employer contribution rate shall be charged: 4.00 percent for the public employees' retirement system.

(2) Beginning September 1, 2009, the following minimum employer contribution rates shall be charged:

(a) 4.25 percent for the school employees' retirement system; and

(b) 5.00 percent for the teachers' retirement system.

(3) Beginning July 1, 2009, the following minimum member contribution rate shall be charged: 4.00 percent for the public employees' retirement system plan 2.

(4) Beginning September 1, 2009, the following minimum member contribution rates shall be charged:

(a) 4.25 percent for the school employees' retirement system plan 2; and

(b) 5.00 percent for the teachers' retirement system plan 2.

(5) Beginning July 1, 2009, an additional minimum 2.75 percent is added to the minimum employer contribution rate of 4.00 percent for the public employees' retirement system until the actuarial value of assets equals one hundred twenty-five percent of the actuarial accrued liability for the public employees' retirement system plan 1 or June 30, 2024, whichever comes first.

(6) Beginning July 1, 2009, an additional minimum 2.75 percent is added to the basic employer contribution rate for the public safety employees' retirement system until the actuarial value of public employees' retirement system plan 1 assets equals one hundred

twenty-five percent of the actuarial accrued liability for the public employees' retirement system plan 1 or June 30, 2024, whichever comes first.

(7) Beginning September 1, 2009, an additional minimum 2.75 percent is added to the minimum employer contribution rate of 4.25 percent for the school employees' retirement system until the actuarial value of public employees' retirement system plan 1 assets equals one hundred twenty-five percent of the actuarial accrued liability for the public employees' retirement system plan 1 or June 30, 2024, whichever comes first.

(8) Beginning September 1, 2009, an additional 5.75 percent is added to the minimum employer contribution rate of 5.00 percent for the teachers' retirement system until the actuarial value of assets equals one hundred twenty-five percent of the actuarial accrued liability for the teachers' retirement system plan 1 or June 30, 2024, whichever comes first.

NEW SECTION. **Sec. 3.** RCW 41.45.054 is decodified, effective September 1, 2005.

NEW SECTION. **Sec. 4.** Section 1 of this act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 2005.

NEW SECTION. **Sec. 5.** Section 2 of this act takes effect July 1, 2009.

--- END ---

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	**035**	**11/24/2004**	**Z-0208.2/ Z-0209.2**

SUMMARY OF BILL:

This bill impacts the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), School Employees' Retirement System (SERS), and Public Safety Employees' Retirement System (PSERS) by establishing required basic employer and state contribution rates and required Plan 2 member contribution rates. Section 1 of the bill establishes a four-year schedule for contribution rates that departs from the normal biennial process for setting rates. The schedule requires four **annual** increases in rates, and departs from the usual formula for allocating contributions among the plans. For PERS and SERS, the rates are lower in the first two years than required by the 2003 actuarial valuation and are higher in the second two years than required by the projected 2005 actuarial valuation. For TRS, the rates are lower in the first year of each biennium and higher in the second year. The schedule thus allows for a gradual phase-in of required increases in contribution rates.

Section 2 of the bill establishes **minimum** basic employer and state contribution rates and required Plan 2 member contribution rates to promote rate stability over time. These minimum rates function as a "floor" beneath which contribution rates are not intended to drop.

The pension funding council is required to review the appropriateness of these rates and recommend to the legislature any adjustments as may be needed due to material changes in benefits or actuarial assumptions, methods or experience.

Effective Date: Section 1 of the bill is effective July 1, 2005. Section 2 of the bill is effective July 1, 2009.

CURRENT SITUATION:

The required employer contribution rates without the four-year phase-in are:

Period	PERS	TRS	SERS
2005-06	5.73%	6.74%	7.56%
2006-07	5.73%	6.74%	7.56%
2007-08	7.28%	10.15%	9.45%
2008-09	7.28%	10.15%	9.45%

Includes the cost of future gain-sharing benefits

The required Plan 2 member contribution rates without the four-year phase-in are:

Period	PERS	TRS	SERS
2005-06	3.38%	2.48%	3.51%
2006-07	3.38%	2.48%	3.51%
2007-08	4.27%	4.01%	4.68%
2008-09	4.27%	4.01%	4.68%

There is currently no contribution rate floor in effect for PERS, TRS, SERS or PSERS.

On September 24, 2004, the Pension Funding Council adopted the "without phase-in" contribution rates for 2005-07 effective July 1, 2005 only if affirmatively approved in advance by the Legislature.

MEMBERS IMPACTED:

We estimate that all active Plan 2 members of PERS, TRS, and SERS would be affected by this bill. This includes 117,262 out of 154,550 active members for PERS, 7,637 out of 66,075 for TRS, and 27,710 out of 49,214 for SERS.

We estimate that for a typical member impacted by this bill, there would be no increase in benefits, but there would be a deferral of contributions. The member contributions would be significantly lower in the first year and significantly higher in the fourth year. The member contributions in the first year would be lower by 0.73% to 1.63% of pay. The member contributions in years two and three would range from being lower by 0.26% of pay to being higher by 0.48% of pay. The member contributions in the fourth year would be higher by 0.90% to 1.66% of pay.

ASSUMPTIONS:

The actuarial present value of future contributions under the proposed schedule is equal to the present value of future contributions under the "without phase-in" schedule. This equivalency is based on an 8% assumed rate of return and the economic and demographic assumptions disclosed in the 2002 Actuarial Valuation Report.

FISCAL IMPACT:

Description:

While the actuarial present value of the change in rates in zero, there is a future value cost on a cash flow basis. The cost shown is the interest on the deferred contributions at the assumed rate of return of 8%.

The estimated fiscal impact does not include cost associated with the contribution rate floor established at July 1, 2009 since the floor rates would not impact contribution rates in the long run. The short-term increase in rates during years in which the floor applies would be offset by lower rates in subsequent years.

The contribution rate floor could result in long-term savings to the extent that investment earnings from the "extra" contributions due to the floor are used to reduce future contribution requirements. There would be a cost to establishing a floor if the extra contributions are used to fund future benefit improvements in lieu of reducing future contribution requirements.

We considered but did not include any cost impact associated with the timing of extra contributions due to the floor or when the extra contributions would be invested relative to investment market cycles.

Actuarial Determinations:

The bill would not change the present value of benefits payable under the Systems. The bill will impact the contribution rates effective for the four years beginning on July 1, 2005 for PERS and the fours years beginning on September 1, 2005 for TRS and SERS as shown below:

System:	PERS	TRS	SERS
Increase (Decrease) in Contribution Rates:			
2005 - 2006 Employee	(1.63%)	(0.73%)	(1.26%)
2005 - 2006 Employer State	(3.23%)	(1.28%)	(2.86%)
2006 - 2007 Employee	(0.13%)	0.27%	(0.01%)
2006 - 2007 Employer State	(0.23%)	0.47%	(0.11%)
2007 - 2008 Employee	0.48%	(0.26%)	0.07%
2007 - 2008 Employer State	0.97%	(0.58%)	0.56%
2008 - 2009 Employee	1.53%	0.90%	1.66%
2008 - 2009 Employer State	2.68%	1.47%	2.59%

Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase (decrease) in funding expenditures is projected to be:

Costs (in Millions):	**PERS**	**TRS**	**SERS**	**Total**
2005-2007				
State:				
General Fund	($54.3)	($30.0)	($23.6)	($107.9)
Non-General Fund	($89.6)	$0.0	$0.0	($89.6)
Total State	**($143.9)**	**($30.0)**	**($23.6)**	**($197.5)**
Local Government	($127.7)	($6.1)	($20.9)	($154.7)
Total Employer	($271.6)	($36.1)	($44.5)	($352.2)
Total Employee	($95.3)	($2.2)	($5.8)	($103.3)
2007-2009				
State:				
General Fund	$66.6	$28.2	$24.4	$119.2
Non-General Fund	$110.0	$0.0	$0.0	$110.0
Total State	**$176.6**	**$28.2**	**$24.4**	**$229.2**
Local Government	$156.6	$5.8	$21.6	$184.0
Total Employer	$333.2	$34.0	$46.0	$413.2
Total Employee	$117.2	$2.2	$5.9	$125.3
2005-2030				
State:				
General Fund	$12.3	$10.0	$5.7	$28.0
Non-General Fund	$20.3	$0.0	$0.0	$20.3
Total State	**$32.6**	**$10.0**	**$5.7**	**$48.3**
Local Government	$28.9	$2.0	$5.0	$35.9
Total Employer	$61.5	$12.0	$10.7	$84.2
Total Employee	$21.8	$0.7	$1.5	$24.0

State Actuary's Comments:

The proposed schedule of deferred rate increases includes the cost of future gain-sharing benefits for the employer. This schedule and fiscal note would require amendment to exclude employer rate increases due to gain-sharing should another piece of Legislation repeal or reduce future gain-sharing benefits.

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Public Employee's Retirement System, Teachers Retirement System and School Employee's Retirement System.

2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This fiscal note is intended for use only during the 2005 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.